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ACTION EUR-25

INFO OCT-01 ISO-00 IO-14 SP-03 AID-20 EB-11 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

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INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

USMISSION EC BRUSSELS

AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY HELSINKI

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY OSLO

AMEMBASSY PARIS

USMISSION OECD PARIS

AMEMBASSY ROME

AMEMBASSY STOCKHOLM

C O N F I D E N T I A L COPENHAGEN 1852

E.O. 11652: GDS

TAGS: EGEN, EFIN, DA

SUBJECT: DENMARK'S ECONOMIC PROBLEMS

REF: COPENHAGEN A-108, JUNE 28, 1974 (NOTAL)

BEGIN SUMMARY. CENTRAL BANK GOVERNOR HOFFMEYER
HAS PUBLICLY ADVOCATED AN INCOMES POLICY FOR
DENMARK AS NECESSARY TO RESOLVE BALANCE OF PAY-
MENTS PROBLEM AND MAINTAIN DENMARK'S INTERNATIONAL
CREDIT RATING. PRIVATELY, HE CONSIDERS INCOMES
POLICY ADOPTION UNLIKELY BECAUSE OF LABOR RESIST-
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ANCE AND BELIEVES DELIBERATE DEFLATIONARY POLICY

ONLY ALTERNATIVE TO ASSURE BOTH CONTAINMENT OF PAYMENTS DEFICIT AND INTERNATIONAL FINANCING WHICH WILL CONTINUE TO BE NEEDED FOR SEVERAL YEARS. NO KRONER DEVALUATION IS PRESENTLY UNDER CONSIDERATION BUT, SHOULD EXCESS CAPACITY DEVELOP WITH AUSTERITY PROGRAM, HOFFMEYER BELIEVES DEVALUATION POSSIBLE. FOR THE TIME BEING, WHILE UNEMPLOYMENT IS RISING, EXPORTS ARE HOLDING UP. END SUMMARY.

1. DCM AND ECONOFF CALLED ON CENTRAL BANK GOVERNOR HOFFMEYER JULY 5 TO DISCUSS RECENT NEWS-PAPER ARTICLE BY HOFFMEYER (REFAIR) IN WHICH HE EXPRESSED CONCERN OVER DENMARK'S INCREASING BALANCE OF PAYMENTS DEFICITS AND INTERNATIONAL CREDIT STANDING. IN THIS ARTICLE HE HAD URGED AN INCOMES POLICY, INCLUDING FREEZING OF ALL INCOMES OVER 10,000 DOLLARS, AS A NECESSITY UNDER PRESENT CIRCUMSTANCES.

2. HOFFMEYER TOLD US THAT ARTICLE HAD ADVANCE APPROVAL OF GOVERNMENT AND THAT IT EXPRESSED OFFICIAL VIEWS WHICH GOVERNMENT DID NOT FEEL IT COULD STATE SO DIRECTLY. HIS EMPHASIS ON ESTABLISHING AN INCOMES POLICY WAS DELIBERATE, BUT HE DID NOT BELIEVE IT WAS POLITICALLY POSSIBLE FOR DENMARK AT THIS TIME. HE FELT THE LABOR UNION POWER STRUCTURE WAS SUCH THAT LOCAL LEADERS, MANY OF WHOM WERE DOCTRINAIRE MARXISTS, WOULD AGGRESSIVELY PUSH WAGE DEMANDS FOR NATION-WIDE BIENNIAL A LABOR CONTRACT WHICH IS UP FOR RENEWAL NEXT SPRING AND ON WHICH NEGOTIATIONS START THIS FALL. HE THOUGHT ONLY POSSIBILITY FOR ACCEPTANCE BY LABOR OF INCOMES POLICY WOULD BE A MASSIVE INCREASE IN UNEMPLOYMENT, NOW ALREADY AT HIGH LEVEL (FOR DENMARK) OF 3 PERCENT. (HOFFMEYER MADE CLEAR HE DID NOT FIND POSSIBILITY OF RISING UNEMPLOYMENT PERSONALLY REPUGNANT.)

3. IF AN EFFECTIVE INCOMES POLICY WERE NOT
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POSSIBLE, HOFFMEYER SAW ONLY TWO OTHER ALTERNATIVES: (A) DOING NOTHING, WHICH WOULD MEAN CONTINUING DETERIORATION OF PAYMENTS BALANCE AND INCREASING NON-COMPETITIVENESS OF DANISH EXPORTS (BECAUSE OF DOMESTIC COST RISES) TO POINT WHERE KRONER WOULD HAVE TO BE DEVALUED AND FORCED ADJUSTMENTS MADE IN ECONOMY, OR (B) ENGAGING IN DELIBERATE DEFLATIONARY POLICY, ALONG PATH

SWEDEN TOOK IN RECENT YEARS, WHICH WOULD MEAN MORE UNEMPLOYMENT, A LARGE WORKER RETRAINING PROGRAM, REDUCTION OF CONSUMER DEMAND, AND ACCELERATED RESTRUCTURING OF ECONOMY WITH FOCUS ON PRODUCTIVE SECTORS AND AWAY FROM CONSTRUCTION AND GOVERNMENT SECTORS.

4. GIVEN REALITIES, HOFFMEYER EXPECTED THAT DEFLATION WOULD BE THE PATH DENMARK WILL BE FORCED TO FOLLOW. HE THOUGHT IT RIDICULOUS THAT IT MUST BE SO, PARTICULARLY SINCE OTHER, AND LARGER, COUNTRIES ARE LIKELY TO FOLLOW SIMILAR PATHS. HE SAW NO ALTERNATIVE, HOWEVER, IF DENMARK IS TO OBTAIN THE INTERNATIONAL FINANCING OF ITS DEFICITS WHICH WILL CONTINUE TO BE NEEDED FOR SOME YEARS TO COME. HE SAID HE WAS VERY CONCERNED OVER DENMARK'S CURRENT CREDIT RATING; HE HAS BEEN GIVEN UNMISTAKABLE IMPRESSION THAT INTERNATIONAL BANKERS CURRENTLY CONSIDER DENMARK'S CREDIT STANDING ONLY SLIGHTLY BETTER THAN ITALY'S. HE THOUGHT THIS CONCLUSION WRONG, BUT INDICATIVE OF THE CONSERVATIVE PHILOSOPHY BY WHICH INTERNATIONAL BANKERS OPERATE. HE NOTED THAT DENMARK'S CURRENT FOREIGN DEBT (AROUND 4 BILLION DOLLARS) IS ONLY 12-13 PERCENT OF GNP AND QUITE MANAGEABLE UNDER NORMAL CIRCUMSTANCES. HOWEVER, CIRCUMSTANCES ARE NOT NORMAL AND, HE SAID, DENMARK WILL HAVE TO PROVE ITS SERIOUSNESS TO THE BANKING COMMUNITY BY AN AUSTERITY PROGRAM FOR PERHAPS ONE TO TWO YEARS.

5. HOFFMEYER RECOGNIZED FULLY THAT, WITH COUNTRIES LIKE THE U.S., FRG, JAPAN AND FRANCE DETERMINED

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NOT TO RUN (OR TO REDUCE) PAYMENTS DEFICITS, IT WILL BE DIFFICULT FOR DENMARK TO REDUCE ITS DEFICIT. HE FEARED THAT, IN A WORLD REQUIRING INDUSTRIAL COUNTRIES TO BE IN OVERALL DEFICIT TO OIL PRODUCERS, THE WEAKER ONES WILL SUFFER. HE WAS NONETHELESS ENCOURAGED BY INDICATIONS THAT DENMARK'S EXPORTS HAVE, SO FAR THIS YEAR, DONE SURPRISINGLY WELL.

6. REGARDING CURRENCY STABILITY, HOFFMEYER SAID THAT THE KRONER IS UNDER NO RPT NO PRESURE AT PRESENT AND THAT HE DID NOT RPT NOT EXPECT IT TO BE IN NEAR FUTURE. HE WAS, NONETHELESS, NOT HAPPY WITH CURRENT EXCHANGE RATES WHICH PROBABLY OVERVALUE THE KRONER. HE SAW

NO ALTERNATIVE SO LONG AS PRESENT LITTLE SNAKE ARRANGEMENT REMAINED AND GERMANY CONTINUED TO FOLLOW POLICIES TO KEEP DM HIGH. HE THOUGHT REVALUATION OF DM (I.E., ITS CENTRAL RATE), WHICH THEN WOULD PROBABLY BE FOLLOWED BY DUTCH AND BELGIANS, WOULD HELP DANISH INTERESTS BUT SAID GERMANS HAVE MADE CLEAR TO HIM THEIR BELIEF THAT IT IS THE WEAKER CURRENCIES WHICH SHOULD CHANGE RATES AND NOT THE STRONGER. SO LONG AS DANISH CAPACITY REMAINS FULLY(OR ALMOST FULLY) UTILIZED, HOFFMEYER SAID DENMARK WILL NOT CONSIDER DEVALUATION. HOWEVER, HE THOUGHT THAT EVENTUALLY, AS AUSTERITY POLICY PROCEEDS AND UNEMPLOYMENT INCREASES, SUFFICIENT EXCESS CAPACITY MIGHT DEVELOP TO MAKE IT APPROPRIATE TO CONSIDER DEVALUATION OF KRONER. (BERLINGSKE TIDENDE JULY 7 CARRIED REPORT FROM ITS BRUSSELS CORRESPONDENT THAT FRG UNDER HELMUT SCHMIDT HAD ADOPTED A "NEW TONE" TOWARD ITS EC PARTNERS, DEMANDING THAT THEY PUT THEIR OWN HOUSES IN ORDER BEFORE REQUESTING GERMAN HELP. HIS REPORTEDLY HAD CAUSED DENMARK, AMONG OTHERS,, TO TELL THE GERMANS THAT THEY MUST EASE UP ON THEIR ANTI-INFLATIONARY POLICY SO AS TO PERMIT THESE COUNTRIES TO EXPORT MORE TO THE FRG.)

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7. EMBASSY COMMENT: HOFFMEYER WAS HIS USUAL CYNICAL AND FRANK SELF IN THIS DISCUSSION. HIS CRYSTAL BALL IS CLOUDY, BUT IN THAT HE IS IN GOOD COMPANY. FACED WITH A HIGHLY UNCERTAIN WORLD, MOUNTING DEFICITS TO FINANCE WITH EMBARRASSINGLY REDUCED CREDIT RATING, AND A SITUATION IN WHICH MONETARY POLICIES NO LONGER SEEM EFFECTIVE AS TOOLS FOR DOMESTIC ECONOMY ADJUSTMENT, HOFFMEYER SEES THE ONLY SHIELD AGAINST BANKRUPTCY IN A CLASSICAL DEPRESSION FOR DENMARK WITH HOPE THAT DEMAND REMAINS HIGH ENOUGH IN THE REST OF THE WORLD TO PERMIT INCREASING MARKETS FOR DANISH EXPORTS. HE SEES THIS AS AN ABSURD POSITION BUT NONETHELESS APPARENTLY NECESSARY UNLESS SOMEONE COMES UP WITH A BRIGHTER IDEA SUCH AS (WHICH HE MENTIONED) AN INTERNATIONAL COOPERATIVE SCHEME PROVIDING MUTUAL CREDIT GUARANTEES. HE SAW NOTHING OF THIS SORT - AT LEAST NOTHING WORKABLE - ON THE HORIZON. DUNNIGAN

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